ICRA

STATE GOVERNMENT FINANCES – Weekly and Quarterly Tracker

Spread between 10-year SDL and G-sec declined to ~64 bps in Q2 FY2021, from ~100 bps in Q1 FY2021

Jayanta Roy
+91 33 7150 1120
jayanta@icraindia.com

Aditi Nayar
+91 124 4545 385
aditin@icraindia.com

Neetika Shridhar
+91 124 4545 305
neetika.shridhar@icraindia.com

Jaspreet Kaur
+91 124 4545 853
jaspreet.kaur@icraindia.com

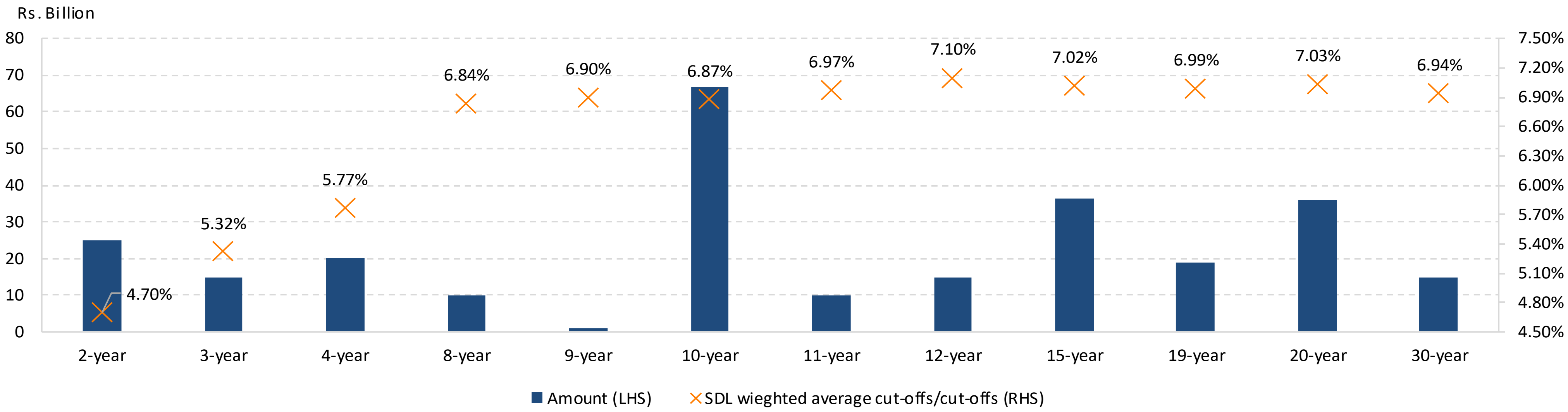
Exhibit 1: 19 state governments and Union-Territories (UTs) raised Rs. 269 billion through state development loans (SDLs) in the auction held on September 29, 2020, a considerable 53.1% higher than the Rs. 176 billion initially indicated for that week; SDL issuance by Andhra Pradesh (AP), Haryana and Maharashtra was 100-200% larger than indicated; moreover, the combined SDL issuance of West Bengal (WB), Kerala, Jammu and Kashmir, Puducherry, Uttarakhand, Meghalaya and Mizoram stood at Rs. 65 billion, nearly a fourth of the total SDL issuance this week, even though these states had not initially indicated that they would participate in the last weekly auction of September 2020; on a YoY basis, the SDL issuance on September 29, 2020 was 32.4% higher than the year ago level

Amount in Rs. Billion	Indicated	Notified*	Raised	Cumulative till this week
Week of September 29, 2020	176	269	269	3,536
Week of September 24, 2019			204	2,254
Growth			32.4%	56.8%

*Note: * Including green shoe*

Source: Reserve Bank of India (RBI); ICRA research

Exhibit 2: SDLs were issued in 12 different tenors on September 29, 2020; Rs. 131 billion (nearly 49% of the total SDLs) was issued in longer maturity buckets, and Rs. 71 billion (26.4%) in shorter tenors; weighted average cut-off of 10-year SDL stood at 6.87%; the spread between the weighted average cut-off of 15-20-year SDLs with the 10-year SDL was in a narrow range of 12-16 bps; Telangana issued a 30-year SDL at a cut-off 6.84%, an attractive 7 bps higher than the weighted average 10-year SDL

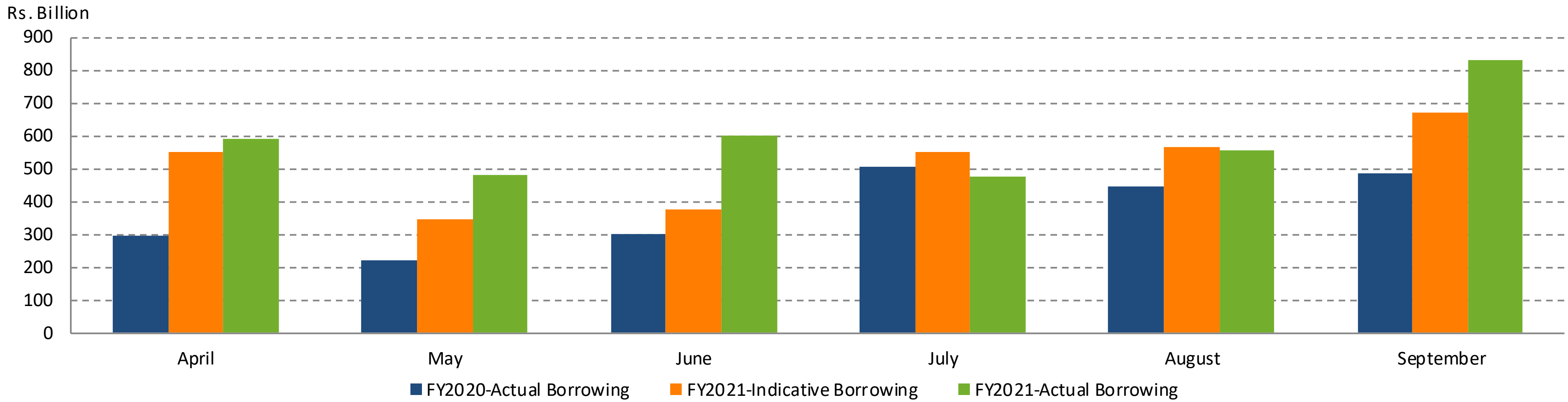


Source: RBI; ICRA research

SDL issuance in Q2 FY2021 modestly higher than indicated, and a considerable 29.5% higher than Q2 FY2020: The gross SDL issuance in Q2 FY2021 stood at Rs. 1,863 billion, a modest ~5% higher than the Rs. 1,783 billion initially indicated in the market borrowing calendar of states released by the RBI on June 30, 2020. In contrast, the actual SDL issuance in Q1 FY2021 (Rs. 1,673 billion), had been a sharp ~32% higher than the indicated amount (Rs. 1,272 billion).

The month-wise actual SDL issuance in Q2 FY2021 compared to the indicated amount for these months reveals a mixed trend (refer Exhibit 3). The SDL issuance in July 2020 stood at Rs. 476 billion, 13.2% lower than the indicated Rs. 549 billion, while the Rs. 556 billion SDLs issued in August 2020 were nearly in line with the indicated Rs. 564 billion. Subsequently, in September 2020, the actual SDL issuance stood at Rs. 831 billion, 23.9% higher than the Rs. 671 billion that was indicated initially by the RBI for that month.

Exhibit 3: Gross monthly SDL issuance in H1 FY2020 and H1 FY2021 and indicative borrowing in H1 FY2021

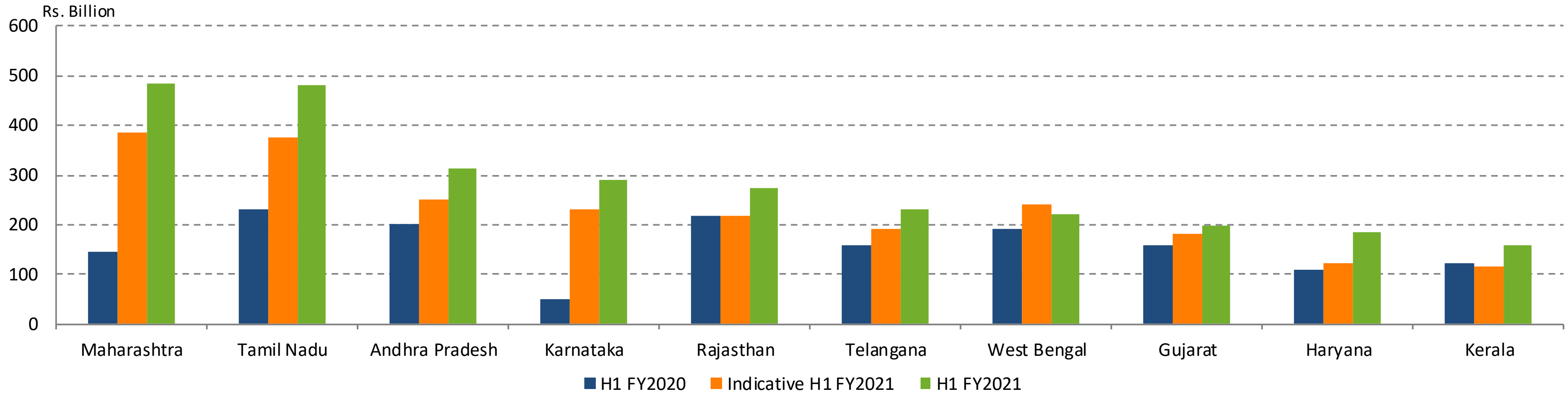


Source: RBI; ICRA research

On a YoY basis, the gross SDL issuance expanded by 29.5% in Q2 FY2021 to Rs. 1,863 billion from Rs. 1,439 billion in Q2 FY2020. We estimate that the SDL redemptions in Q2 FY2021 halved to Rs. 264 billion from Rs. 464 billion in Q2 FY2020. Accordingly, the net SDL issuance increased by a sharper 64.0% to Rs. 1,599 billion in Q2 FY2021 from Rs. 975 billion in Q2 FY2020. On a sequential basis, the pace of growth of the gross and net SDL issuance moderated in Q2 FY2021 from the high 105.2% and 135.6%, respectively, in Q1 FY2021.

Gross SDL issuance expanded by a substantial 56.8% in H1 FY2021: The gross SDL issuance expanded by a substantial 56.8% to Rs. 3,536 billion in H1 FY2021 from Rs. 2,254 billion in H1 FY2020. Maharashtra (by Rs. 340 billion), Tamil Nadu (TN; by Rs. 248 billion), Karnataka (by Rs. 240 billion), Andhra Pradesh (AP; by Rs. 112 billion) and Haryana (by Rs. 75 billion), accounted for more than 90% of the incremental market borrowing in H1 FY2021 (refer Exhibit 4). Reflecting our estimate of a decline in SDL redemptions to Rs. 511 billion in H1 FY2021 from Rs. 674 billion in H1 FY2020, the net SDL issuance rose by an even higher 91.4% in H1 FY2021 to Rs. 3,025 billion from Rs. 1,580 billion in H1 FY2020.

Exhibit 4: Actual gross SDL issuances in H1 FY2020 and H1 FY2021 and indicative borrowing in H1 FY2021 of top 10 issuers in H1 FY2021

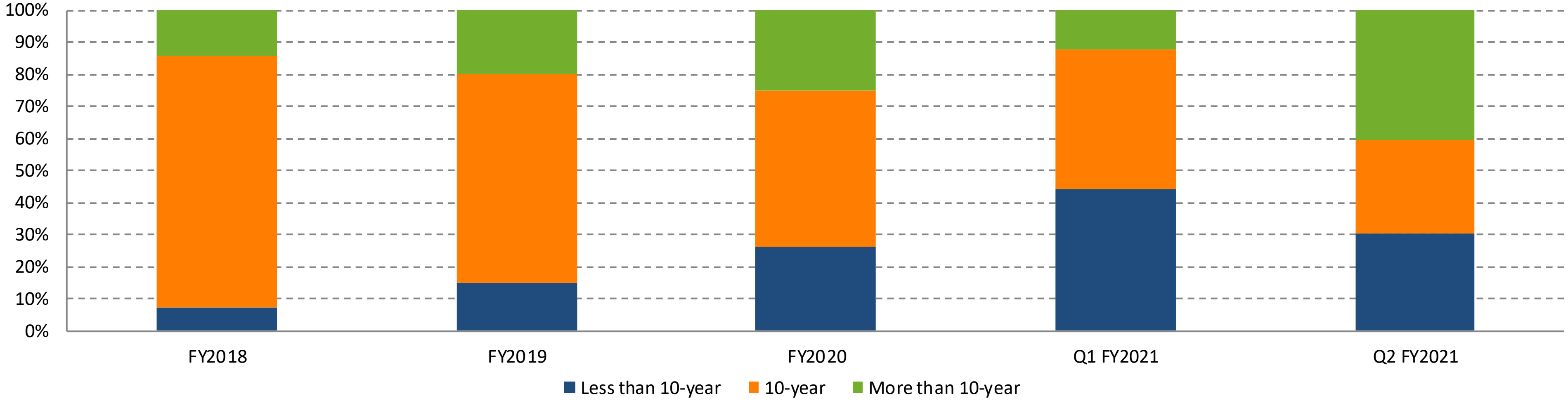


Source: RBI, ICRA research

The high market borrowings by the state governments in H1 FY2021 reflect the expectedly wide gap between their revenue receipts and expenditure led by the adverse impact of the Covid-19 pandemic on the fiscal health of the state governments. The curtailed consumption of several goods and services, during the nationwide lockdown enforced by the Government of India (GoI) in April 2020 (only essential services permitted), May 2020 (with some graded relaxations), June 2020 (enforced only in the containment zones) and the localised lockdowns by several states in Q2 2021 to contain the spread of Covid-19 pandemic, has negatively impacted the tax collections of the state governments. On the other hand, the ongoing crisis, is expected to have led to additional spending on healthcare activities, providing free food grains, cash transfers to offset loss of livelihoods etc. by some of the state governments, which would have bloated their revenue expenditure.

Rise in issuance of longer tenor SDLs: The amount of SDL issuance in the greater than 10-year (longer tenor) maturity bucket rose sharply to Rs. 749 billion or 40.2% of the total SDL issuance in Q2 FY2021 (refer Exhibit 5) from a modest Rs. 204 billion or ~12% of the total SDL issuance in Q1 FY2021 in line with the flattish yield curve at the longer end.

Exhibit 5: Share of less than 10-year, 10-year and more than 10-year issuances in total issuances during FY2018-FY2020 and in Q1 and Q2 FY2021

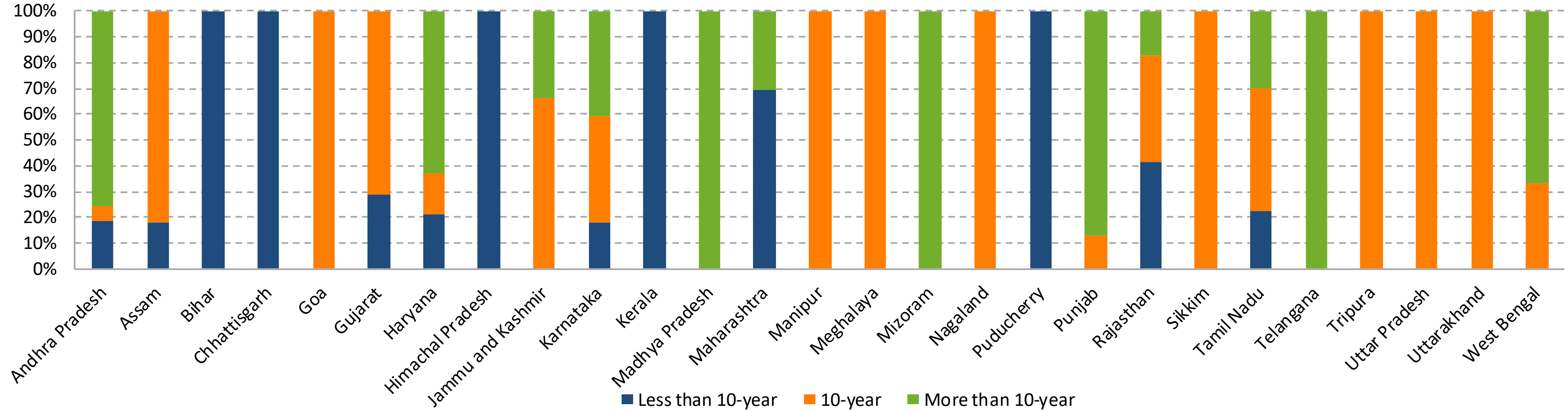


Source: RBI, Clearing Corporation of India Limited, ICRA research

The number of states that issued longer-tenor SDLs doubled to 12 (AP, Haryana, Jammu & Kashmir or J&K, Karnataka, Madhya Pradesh or MP, Maharashtra, Mizoram, Punjab, Rajasthan, TN, Telangana, and West Bengal or WB) in Q2 FY2021 from six (AP, Karnataka, Kerala, Maharashtra, Rajasthan and TN) in Q1 FY2021. Nearly half of the total longer tenor SDL issuance in Q2 FY2021 was conducted by AP (Rs. 123 billion), Telangana (Rs. 105 billion), Karnataka (Rs. 90 billion) and WB (Rs. 80 billion).

After issuing a modest ~7% in the longer tenor SDLs in Q1 FY2021, AP issued a substantial ~75% of the total SDLs in Q2 FY2021 in longer tenor SDLs (refer Exhibit 6). Moreover, Telangana exhibited a strong shift in preference for longer tenor SDLs in Q2 FY2021 compared to shorter tenor in Q1 FY2021; this state government issued Rs. 105 billion in Q2 FY2021, entirely through longer tenor SDLs (20-30-year SDLs) compared to nil long-term issuance in Q1 FY2021.

Exhibit 6: Proportion of SDLs issued by state governments in less-than-10-year, 10-year and greater-than 10-year in Q2 FY2021



Source: RBI; ICRA research

Karnataka enhanced its longer tenor SDL issuance to ~41% of total in Q2 FY2021 from ~29% in Q1 FY2021. Moreover, it maintained a preference for issuing 11-15-year SDLs in Q2 FY2021, in line with the trend seen in Q1 FY2021. Similarly, after issuing nearly a fourth of its SDL issuance in the 30-35-year tenor in Q1 FY2021, TN increased its SDL issuance in the 20-30-year tenor to ~30% in Q2 FY2021. Rajasthan issued Rs. 20 billion SDLs in 30-35-year SDLs, which was equivalent to ~17% of the total SDLs issued by the state government in Q2 FY2021; in Q1 FY2021, ~9% of its total issuance had been in the 30-year maturity bucket. Out of the total Rs. 230 billion SDLs issued by Maharashtra in Q2 FY2021, ~30% were in the 11-12-year tenor, whereas it had issued a lower ~20% of the total SDLs in the 11-year segment in Q1 FY2021.

Haryana (63.2%), WB (66.7%), Punjab (87.4%), MP (100%) and Mizoram (100%) issued a healthy proportion of their total SDL issuance in longer tenor in Q2 FY2021, compared to issuance only in the 10-year and below buckets in Q1 FY2021. The combined SDL issuance of Rs. 272 billion by these five states, contributed more than a third of the Rs. 749 billion SDLs issued in the longer tenor in Q2 FY2021. Notably, Mizoram issued a longer tenor for the first time in Q2 FY2021.

The amount of SDL issuance in the lower than 10-year (shorter tenor) bucket declined sharply to Rs. 562 billion in Q2 FY2021 or 30.1% of the total SDL issuance in that quarter, from Rs. 741 billion or 44.3% of total in Q1 FY2021. Bihar (100.0%), Maharashtra (69.6%), Rajasthan (41.5%), Karnataka (18.2%) and TN (22.5%) issued 18-100% of their total SDLs in Q2 FY2021, in the shorter tenor. The total SDL issuance by these five states accounted for nearly two-thirds of the total shorter tenor issuance in Q2 FY2021.

The shift in preference for longer tenor SDLs in Q2 FY2021 appears to have been driven by attractive SDL yields that prevailed at the longer end of the curve in Q2 FY2021. Moreover, some state governments could be anticipating larger supply of SDLs in H2 FY2021, which may harden SDL cut-offs in that period. Additionally, issuing longer tenor SDLs helps in elongating the maturity profile of the stock of SDLs and reduce rollover risks for the state governments.

Spread with 10-year G-sec eased to around 64 bps in Q2 FY2021 from around 100 bps in Q1 FY2021: The uncertainty around the intensity and duration of the Covid-19 pandemic and the associated loss in tax collections had resulted in the widening of the spread between the weighted average 10-year SDL and the 10-year G-sec to above 100 bps in April 2020. Various measures announced by the RBI in Q1 FY2021 and the gradual relaxations in lockdowns in that quarter, had led to cooling off the spread between the 10-year SDL and G-sec to 82 bps in May 2020 and further to 74 bps in June 2020 (refer Exhibit 7). Overall, the spreads had remained volatile and elevated in Q1 FY2021.

In terms of the month-wise trend in Q2 FY2021, the spread between the 10-year SDL and the G-sec cooled to 60 bps in July 2020 from 74 bps in June 2020, which could have benefitted from the lower-than-indicated SDL issuance in July 2020.

The RBI issued the new 10-year G-sec at a cut-off of 5.77% on August 3, 2020, 3 bps lower than the closing of the old 10-year benchmark G-sec yield at 5.80%. Subsequently, on August 6, 2020, the Monetary Policy Committee (MPC) left the policy Repo rate unchanged at 4%, in contrast to expectations of a 25 bps Repo rate cut by a section of the market participants. Moreover, the CPI inflation for July 2020 remained above the upper limit of the MPC's medium-term inflation target range of 4%+/-2%, dousing hopes of an impending rate cut. Further, concerns regarding the additional supply of bonds on account of the challenging fiscal situation of the GoI as well as of the state governments started to push up yields. Overall, there was a hardening of 24 bps and 35 bps in the 10-year SDL and the G-sec yield between the last and first weekly SDL auction held in August 2020. However, the spreads between the two eased from 60-64 bps in the first fortnight to 54 bps in the second fortnight of August 2020.

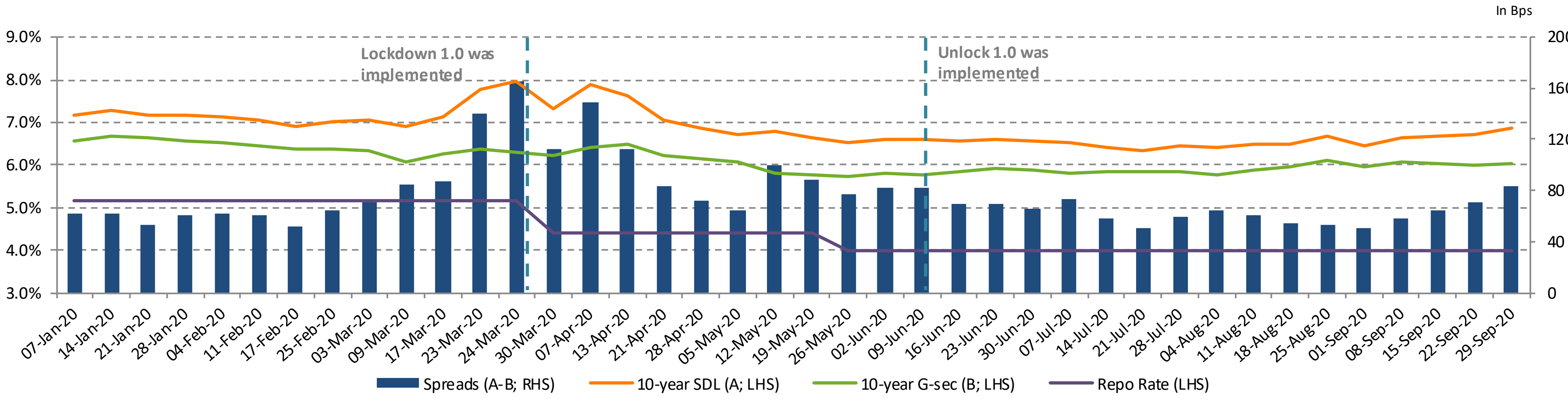
On August 31, 2020, the RBI announced several measures[1] to ensure orderly market conditions while reiterating that the market borrowing programme of the GoI and the states for FY2021 will be completed by the RBI in a non-disruptive manner. Aided by such announcements, in the auction dated September 1, 2020, the weighted average 10-year SDL cut-off declined sharply by 21 bps from the week ago level to 6.45%, while the 10-year G-sec cooled by 18 bps to 5.94%.

The spread between the SDL and G-sec moderated to 51 bps in the first weekly auction in September 2020. However, the bulk of the fall in yields displayed on September 1, 2020, was reversed in next SDL auction, as the 10-year weighted average cut-off rose by 19 bps to 6.64% on September 8, 2020. Reflecting an 11 bps increase in 10-year G-sec yield to 6.06%, the spread in this auction inched up to 58 bps.

---

[1] *The measures announced by the RBI on August 31, 2020 included, (a) conducting of additional special open market operation (OMO) involving the simultaneous purchase and sale of G- sec for Rs. 200 billion in September 2020, with a commitment to conduct further OMOs depending on market conditions (b) term-repos of Rs. 1,000 billion (c) from September 1, 2020, Banks allowed to hold fresh SLR securities under Held-To-Maturity up to an overall limit of 22% of Net Demand and Time Liabilities till March 31, 2021 and (d) to conduct market operations as required through a variety of instruments*

Exhibit 7: Spreads between 10-year G-sec and weighted average cut-offs of SDLs



Source: RBI; ICRA research

The next three auctions witnessed a rise in 10-year weighed average cut-off to 6.67%, 6.72% and 6.87%, respectively, on September 15, 2020, September 22, 2020 and September 29, 2020. However, the 10-year G-sec yield continued to ease to 6.03% and 6.01%, before increasing to 6.04%, respectively, in the last three weekly auctions held in September 2020. Reflecting the divergence in the movement of the 10-year weighted average SDL cut-off and the G-sec yield, the spread between the two widened from 64 bps on September 15, 2020 to 71 bps on September 22, 2020 and further to 83 bps on September 29, 2020.

In Q2 FY2021, the weighted average 10-year SDL cut-off moderated to 6.60% from 7.03% in Q1 FY2021 (refer Exhibit 8), and the average 10-year G-sec yield cooled only mildly to 5.96% from 6.02% in Q1 FY2021. The relatively sharper 43 bps reduction in the 10-year SDL weighted average cut-off in Q2 FY2021 from Q1 FY2021 compared to the decline of 6 bps in the 10-year G-sec yield, led to the narrowing of the spread between the two to around 64 bps in Q2 FY2021 from around 100 bps in Q1 FY2021.

With a decline in the proportion of shorter tenor issuance, the weighted average cut-off of shorter tenor SDLs is estimated to have declined by a sharp 54 bps to 5.44% in Q2 FY2021 from 5.98% in Q1 FY2021. Accordingly, the spread between the weighted average shorter tenor SDLs and the 10-year SDLs widened to 116 bps in Q2 FY2021 from 104 bps in Q1 FY2021. The weighted average cut-off of the longer tenor SDLs is estimated to have eased to 6.70% in Q2, 48 bps lower than the 7.18% in Q1 FY2021. The spread between the weighted average longer tenor SDLs and the 10-year SDLs narrowed to a muted 10 bps in Q2 FY2021 from 15 bps in Q1 FY2021, despite the sharp increase in longer tenor issuance in Q2 FY2021.

Exhibit 8: Weighted average SDL cut-offs and spreads

	Q1 FY2021	Q2 FY2021
Weighted average SDL cut-offs		
(A) Shorter tenor	5.98%	5.44%
(B) 10-year	7.03%	6.60%
(C) Longer tenor	7.18%	6.70%
(D) 10-year G-sec	6.02%	5.96%
Spreads in bps		
A-B	-104	-116
B-D	101	64
C-B	15	10

Source: RBI; ICRA Research

ABOUT ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

The ICRA Factor

Our services are designed to

- Provide information and guidance to institutional and individual investors/creditors;
- Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;
- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

Business Contacts

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

Media and Public Relations

Ms. Naznin Prodhani
E-mail: communications@icraindia.com
Tel: +91 124 4545 860

Registered Office:

1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi - 110 001
Tel: + 91 11 2335 7940-45

Corporate Office:

Building No.8, 2nd Floor,
Tower A, DLF Cyber City Phase II,
Gurgaon- 122 002
Tel: +91 124 4545300

Ahmedabad

1809-1811, Shapath V,
Opposite Karnavati Club
S.G. Highway, Ahmedabad - 380015
Tel: +91 79 4027 1500/01

Bengaluru 1

'The Millenia', Tower- B, Unit No. 1004,
10th Floor,1 & 2 Murphy Road,
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber,
15-16, Trinity Circle, M.G. Road,
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5th Floor, Karumuttu Centre,
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

No. 7-1-58, 301, 3rd Floor, 'CONCOURSE',
Above SBI-HPS Branch, Ameerpet,
Hyderabad - 500 016
Tel: +91 40 4920 0200

Hyderabad 2

4A, 4th Floor, SHOBHAN,
6-3-927, A&B Somajiguda,
Raj Bhavan Road,
Hyderabad – 500082
Tel: +91 40 40676500

Kolkata

A-10 & 11, 3rd Floor,
FMC Fortuna 234/3A,
A.J.C. Bose Road,
Kolkata -700 020
Tel: +91 33 7150 1100/01

Mumbai

3rd Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi,
Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5th Floor, Symphony,
S. No. 210 CTS 3202 Range Hills Road,
Shivajinagar,Pune - 411 020
Tel: +91 20 2556 0194, 020 6606 9999

Email: info@icraindia.com
Helpdesk: 9354738909
Website: www.icra.in/ www.icraresearch.in